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SUBJECT: WEATHERFORD TO BUY TNK-BP SERVICES UNIT FOR \$450 MILLION

Classified By: Econ MC Eric Schultz for Reasons 1.4 (b/d)

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Summary  
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¶1. (C) American (but Swiss-registered) oil field services company Weatherford agreed on May 29 to buy TNK-BP's oil field services (OFS) enterprises in a deal worth approximately \$450 million. It is one of the largest foreign investments in Russia in recent years and certainly the largest since Russia's economiclQ1=,Q}rd's confidence in the market for its services, we are not yet convinced that it signals restored broader investor confidence in Russia. End summary.

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TNK-BP EXITS OFS TO FOCUS ON CORE-BUSINESS  
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¶2. (C) As part of what COO Tim Summers recently told us will be his company's focus on streamlining operations and focusing on its core oil business, TNK-BP announced on May 29 that it would sell its oil field services (OFS) unit to Weatherford, a Swiss-registered but U.S.-headquartered OFS company with extensive global operations. The deal still requires approval from Russia's Federal Anti-Monopoly Service (FAS), but given that it enjoys the support of all elements of TNK-BP, including its new Chairman, Alfa Group's head and oligarch Mikheil Fridman, this is not expected to be an obstacle.

¶3. (SBU) According to its press release, Weatherford will acquire TNK-BP's OFS business in exchange for 24.3 million Weatherford shares of common stock. Weatherford's filing with the U.S. Securities and Exchange Commission further notes that Weatherford will guarantee a price floor of \$18.50 per share for its stock, valuing the deal at \$450 million. The deal reportedly also includes "other considerations," thought to be a reference to TNK-BP's continued use of OFS through the unit, despite the change in ownership.

¶4. (C) TNK-BP's International Affairs Advisor Alexander Mikhailants told us June 1 that TNK-BP will receive the Weatherford stock at the close of the deal and that it is free to sell the shares at anytime. He said the sale is part of a long-term TNK-BP strategy to divest from non-core assets and that the company had decided to exit the OFS business 3 years ago. He reiterated that the deal has the unanimous backing of both BP and its Russian partners.

15. (C) According to Mikhailants, TNK-BP's main concern with the deal was its ability to continue to access the technology and services of the OFS unit and that the deal guarantees this access. For Weatherford, he said, the use of stock as payment allows the company to conserve cash, which it intends to use for future investments in the business.

16. (C) Weatherford's director of marketing for Russia, Katja Petrova, told us June 1 Weatherford has been looking to expand its capabilities in Russia and that this deal offered that opportunity. She said, however, that while the agreement awaits regulatory review from the FAS she could not comment on the extent to which this acquisition would enhance Weatherford's market position in Russia. She added that over 80% of the Russian OFS market is controlled by local firms and by the Russian oil companies' own services units. She indicated that many companies are interested in selling off their services businesses.

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A CATALYST FOR M AND A ACTIVITY?  
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17. (C) Alfa Bank Head of Research Ron Smith told us June 2 that his firm believes the deal may serve as a catalyst for new mergers and acquisitions activity in the Russian oil-field services sector, including further deals by

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Weatherford. He noted that based on Weatherford's apparent valuation of TNK-BP's OFS business, other OFS companies in Russia are undervalued.

18. (C) Halliburton's former Russia country manager Simon Turton (protect) had told us previously that the best way for foreign OFS companies to expand in Russia was through acquisitions. However, he said these acquisitions could be very complicated due to the difficulties in conducting appropriate due diligence in a sector fraught with unconventional business practices and outright corruption.

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COMMENT  
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19. (C) Weatherford's new investment in Russia is the largest by a foreign firm since Russia's economic downturn began last August, when foreign investors cooled on Russia following the war with Georgia. Although the Russian stock market has been among the world's strongest performers this year, a direct result of rising oil prices globally, we are not convinced that this deal signals a broader renewed appetite for investing in Russia. Many experts, even traditionally bullish ones, are wary of a market correction and fear oil prices are being driven by speculation rather than demand. In addition, Russia remains underweight in institutional GEM portfolios despite the rising markets with little new money coming in.

10. (C) Moreover, the OFS business in Russia may present specific opportunities that do not translate to the larger economy. Russia is the world's largest producer of hydrocarbons, but with a relatively inefficient existing stock of capital and technology, and weak knowledge of modern best practices. Russia needs, and GOR officials have frequently publicly welcomed, Western technology and expertise to produce oil and gas more efficiently. And critically, services do not threaten Russian ownership of oil and gas assets that the GOR considers "strategic."

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